Healthcare Real Estate Investment Trusts
John Roberts
J.J.B. Hilliard, W.L. Lyons, LLC
502.588.1165 / jmroberts@hilliard.com
Institutional Sales Desk: George Moorin
502.588.9141 /GMoorin@hilliard.com
February 13, 2017

COMPANY UPDATE

Key Metrics

HCP - NYSE - as of 2/10/17	$30.70
2-3 Year Price Target	N/A
52-Week Range	$22.86 - $36.81
Shares Outstanding (mm)	467.9
Market Cap. ($mm)	$14,364.5
1-Mo. Average Daily Volume	2,793,140
Institutional Ownership	95.3%
Debt/Total Capital Dec-16	40.3%
Est 3-year FFO Growth Rate	4.5%
Est 3-year Dividend Growth Rate	2.5%
Dividend	$ 1.48
Dividend Yield	4.82%
Est. Fixed Charge Coverage	3.9 X

FFO

	2015		2016	Prior 2017E	Current 2017E	
1Q	$0.79	--	$0.69	$0.47	$0.49	
2Q	$0.79	--	$0.74	$0.49	$0.50	
3Q	$0.79	--	$0.72	$0.51	$0.50	
4Q	$0.80	--	$0.59	$0.52	$0.51	
Year	$3.16		$2.74	$1.99	$1.99	*
P/E	9.7x		11.2x		15.4x	

*-May not add due to rounding

Revenue ($mm)

	2015		2016	Prior 2017E	Current 2017E
1Q	$610.8	--	$640.8	--	$546.30
2Q	$607.5	--	$662.2	--	$557.40
3Q	$658.0	--	$654.3	--	$567.10
4Q	$668.0	--	$540.0	--	$575.90
Year	$2,565.8		$2,457.3	$2,200.0	$2,246.7

** - Revenue numbers not restated.

Company Description: *HCP, Inc., formerly known as Health Care Property Investors, Inc., headquartered in Long Beach, CA, is a real estate investment trust (REIT) that has investments in assisted living, medical office buildings, laboratory facilities and other healthcare facilities located throughout the country.*

HCP, Inc.

HCP -- NYSE – Neutral-3

Fourth Quarter Conference Call Highlights

Investment Highlights

- Following HCP's conference call we are fine-tuning our expectation for net acquisitions and investments to $500 million, with all of the divestiture activity discussed knocking our numbers down a bit. Also, we are increasing our G&A expense assumption to about in the middle of management's guidance range. Despite that, with fine-tuning other line items, our 2017 FFO estimate remains at $1.99 a share, above guidance and the current consensus. We note our estimate includes investments above that which management is guiding.
- The REIT group has seen a sell-off recently on worries about Fed rate increases, in our opinion. We expect the group to remain weak in relation to the market on those worries. However, we envision a lower level of rate increases than generally expected, and if we are correct the group's valuation may prove to be attractive later in the year.
- While HCP reported a solid quarter beating the consensus, and we anticipate that guidance is likely to be somewhat conservative in relation to what will be the actual results, we are reticent to recommend purchase of the stock at this point. We have no doubt that management is likely to want to under-promise and exceed that conservative guidance, as new management will want to get off on a good foot. We believe the former management has left the new management group in a strong operating position, and in a place to do well going forward. This could allow for a positive rating down the road if the share price comes down, given no change in fundamentals. However, until then, we are retaining our Neutral rating and suitability rating of 3.

Note Important Disclosures on Pages 6-7.
Note Analyst Certification on Page 6.

Conference Call Discussion

HCP management spent most of the conference call discussing and answering questions pertaining to recycling its assets, selling off non-core assets and replacing them with assets more within its core strategic direction. In particular, they are looking to limit debt investments, older properties and those that are not within the geographic focus of the company. They will be targeting the three core focus areas, being senior housing, medical office and lab space. There will be development and redevelopment within each of these areas, as well as acquisitions. Management discussed the reduction in its Brookdale (BKD-$15.15) exposure through its announced sale and the level of dilution that it will see as a result. As such, this issue will likely weigh on the company until it is resolved and even after these sales BKD will continue to account for a significant amount of HCP's business.

When the company completes the sale of the first tranche of BKD properties, which is expected to be completed before the end of Q1 and will result in $1.1 billion in proceeds, management anticipates using all of this capital to further reduce debt. As a result of this pay down, management will have no maturities due until 2019. On the remaining BKD properties to be sold/re-leased, management anticipates it is likely to sell the properties, as it is receiving interest in these remaining assets at a very attractive sub-6% cap rate. The company is also continuing to see strong demand on its Cove development project in the San Francisco area.

Operating fundamentals for the year were reasonable, with same store NOI up about 3.7%, at the high end of guidance. Looking forward into 2017 management is looking for same store NOI growth of 2.5% - 3.5%. These numbers are somewhat above recent levels, but this is largely a function of the company divesting its low growth skilled nursing assets and concentrating on higher growth areas, such as lab space. We are assuming a number towards the high end of the range as we believe the new management team is likely to stay conservative to not disappoint investors. Management also anticipates general and administrative expense of $87 million, less than we had originally modeled for the firm, and lower than the 2016 number. Our revised estimate is nearly $3 million more than our original expectation to account for expenses related to the acquisitions we are projecting for 2017. Looking back to 2016, the results disclosed excluding the issues with the divested assets were reasonable in our view. The coverage ratio for the senior housing portfolio on a same store basis was 1.11 times. On the occupancy side, the company generally saw improvement throughout its portfolio, with the life sciences sector showing very strong occupancy at 97.3%. Management also discussed the continuing roll-out in the construction of its San-Francisco based The Cove at Oyster Point, a life science development.

Looking forward, management offered a guidance range of $1.89-$1.95 a share for 2017 FFO. This is down solidly from the 2016 number of $2.74 a share, a function of the spin-off of the skilled nursing assets and the ongoing sale of assets to BKD. These issues will continue to weigh on reported FFO going forward, and if the company does not undertake the degree of investment that we are estimating, we will likely see a shortfall to our estimate. So as not to confuse investors, we are adjusting our numbers to comport with management guidance, although on a year over year basis it will not.

First Quarter and 2017 Outlook

As noted earlier, we are retaining our estimate for 2017 FFO at $1.99 a share, which is $0.04 above the high end of management's guidance, and compares to the consensus of $1.92 for the year. We feel comfortable with our estimate as we do not anticipate HCP will be absent from the acquisition markets for the full year, although timing is an issue with all of the divestitures that are going to take place over the coming year and the uncertainty in their timing. We are assuming $500 million in net new investments for the full year, accounting for about $0.05 in additional FFO. Our 1Q FFO estimate is now $0.49 a share, with no positive net investment expected for the first quarter due to heavy divestiture activity. This compares to the consensus estimate for the first quarter of $0.47 a share. Even though we are above guidance, we feel comfortable with our estimate. We will be paying close attention to how management undertakes its divestiture and acquisition activity for signs that might force us to change our expectations going forward. At this point we are introducing a 2018 FFO estimate of $2.07 a share, which compares to the pre-earnings consensus number of $2.00 a share.

Valuation

Using our $1.99 a share estimate for 2017, HCP shares are trading at 15.4 times current year FFO. This is a premium to the peer group, and above the historic trading range over the last decade-plus. This is a function of the spin-off or sale of lower multiple assets. As such, investors are likely to afford the company a higher multiple going forward. The peer group now trades at 14.8 times. However, we would benchmark HCP more towards the other two large healthcare REITs, Ventas and Welltower, Inc., which trade at 14.5 and 14.6 times current year FFO with the average of two companies at 14.55 times. With the shares trading at a premium to the peer group, and the likelihood of near term pressure on FFO with the divestitures, we do not find the company's shares at an attractive enough valuation to recommend purchase at the current time.

Health Care REITs		Closing Price	Current		2016E			2-Year Average	Price / FFO	
	Symbol	2/10/2017	Dividend	Yield	Payout Ratio	2016E	2017E	Growth Rate	2016E	2017E
Welltower, Inc.	HCN	$65.87	$3.44	5.2%	76.3%	$4.55	$4.51	1.5%	14.5x	14.6x
National Health Investors	NHI	$74.41	$3.60	4.8%	69.0%	$4.87	$5.22	5.7%	15.3x	14.3x
Healthcare Realty Corp.	HR	$30.52	$1.20	3.9%	70.2%	$1.63	$1.71	3.4%	18.7x	17.8x
Ventas, Inc.	VTR	$61.77	$2.92	4.7%	68.5%	$4.13	$4.26	-2.4%	15.0x	14.5x
LTC Properties, Inc.	LTC	$46.26	$2.28	4.9%	71.3%	$3.06	$3.20	6.9%	15.1x	14.5x
Health Care Sector Average		**$58.14**	**$2.79**	**4.8%**	**71.1%**	**$3.80**	**$3.93**	**1.9%**	**15.3x**	**14.8x**
HCP, Inc.	HCP	$30.70	$1.48	4.8%	74.4%	$2.74	$1.99	-18.7%	11.2x	15.4x

Note: NHI and VTR are rated Neutral, and HR, HCN and LTC Underperform by Hilliard Lyons. Source: NAREIT, Baseline and Hilliard Lyons' estimates.

HCP and VTR 2016 FFO numbers are actuals.

Rating

At this point we are holding our rating on HCP at Neutral. While we might find it attractive at a slightly lower price later in the year, especially with the new management team, we believe investors should likely stay on the sidelines and wait for a more attractive entry point.

Risk Factors

There are a number of risks in owning HCP shares and REITs as an investment group. REITs in general need access to debt capital to grow, if such debt capital is unavailable, the company may have difficulty in growing. The company's dividend is very attractive to shareholders and HCP, as well as REITs in general, will see their prices rise and fall with the change in overall interest rates. Should rates rise, that could hurt HCP's share price. Because of their thirst for debt, changes in interest rates can also impact a REIT's cash flow and ability to make accretive acquisitions. The company has exposure to a variety of classes of healthcare-related real estate, such as senior housing and medical office buildings that can have boom and bust cycles that can impact values and rates and potentially negatively impact their values and cash flow generating ability. It is always possible that the company could make a poor acquisition in the future, which could have a negative impact. Its move into operating assets could also have a negative impact if operating issues arise at any of its owned and operated properties. Changes in the Affordable Care Act could also pose problems. Labor issues with the company's tenants could create profit pressures, and thus lower rental coverage.

Annual yield is calculated by dividing the distribution amount by the current market price of the security. For US income tax purposes, the Company may classify all or a portion of its distributions as dividends or other non-dividend distributions. Note that for some investors, for US income tax purposes all or a portion of the Company's 2016 dividend or distribution was treated as return of capital and not as “dividend income” as reflected on the IRS Form 1099-Div for the 2016 tax year. The Company generally makes a final determination regarding the proper tax treatment of distributions Lyons after calendar year end. We urge each shareholder to consult with his or her own tax advisor to determine the tax consequences of the distributions received, including any state, local or foreign tax considerations.

Table 1. Consolidated Income Statement

	2013	2014	2015					2016					2017E				
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Revenues:																	
Rental and other revenue	$1,131,353	$1,174,256	$275,082	$276,734	$293,566	$299,100	$1,144,482	$297,194	$299,076	$297,178	$286,968	$1,180,416	$291,410	$296,730	$303,963	$311,872	$1,203,975
Tenant recoveries	$100,718	$110,688	$29,896	$31,376	$33,084	$32,129	$126,485	$31,737	$33,930	$35,195	$34,565	$135,427	$34,241	$35,163	$36,324	$37,581	$143,307
Income from direct financing leases	$636,881	$663,070	$167,078	$156,181	$155,717	$154,859	$633,835	$127,968	$132,100	$170,752	$14,789	$445,609	$14,952	$15,116	$15,282	$15,451	$60,801
Resident fees and services	$149,850	$241,965	$105,013	$106,838	$155,290	$158,312	$525,453	$165,763	$164,202	$130,663	$186,118	$646,746	$187,588	$189,070	$190,564	$192,069	$759,292
Investment management fee income	$1,847	$1,809	$460	$458	$454	$501	$1,873	$91	$81	$0	$0	$172	$0	$0	$0	$0	$0
Interest & other	$87,743	$74,491	33,262	35,945	19,842	23,135	$112,184	18,029	32,787	20,482	17,510	$88,808	18,103	21,290	20,983	18,961	$79,337
	$2,108,392	$2,266,279	$610,791	$607,532	$657,953	$668,036	$2,544,312	$640,782	$662,176	$654,270	$539,950	$2,497,178	$546,293	$557,369	$567,116	$575,933	$2,246,712
Expenses																	
Interest Expense	$435,758	$439,742	$116,780	$118,632	$122,157	$122,027	$479,596	$122,062	$121,333	$117,860	$103,148	$464,403	$99,559	$100,554	$102,120	$104,166	$406,399
Depreciation & Amort.	426,402	459,995	114,522	120,403	134,704	141,156	510,785	141,322	141,386	142,874	146,927	572,509	139,202	139,916	141,820	144,319	565,257
Operating expense	301,280	388,369	132,031	136,342	173,515	176,446	618,334	176,955	180,125	188,747	195,648	741,475	193,994	197,721	207,207	207,624	806,546
Impairment Charge, Other	-	-	470,476	33,719	97,882	826,942	1,429,019	-	-	-	-	-	-	-	-	-	-
Acquisition Expenses			3,390	18,407			21,797	2,475	14,527	17,568	3,760	38,330	5,000	5,000	5,000	5,000	20,000
General & Administrative	109,430	95,551	24,773	28,845	22,087	21,870	97,575	25,499	22,793	34,787	20,600	103,679	21,032	21,180	22,401	21,310	85,923
Total Expenses	$1,272,870	$1,383,657	$861,972	$456,348	$550,345	$1,288,441	$3,157,106	$468,313	$480,164	$501,836	$470,083	$1,920,396	$458,787	$464,371	$478,549	$482,418	$1,884,125
Income from Operations	$835,522	$882,622	($251,181)	$151,184	$107,608	($620,405)	($612,794)	$172,469	$182,012	$152,434	$69,867	$576,782	$87,506	$92,999	$88,568	$93,515	$362,587
Minority interests	($15,969)	($16,795)	($3,446)	($3,233)	($2,908)	$23,397	$13,810	($3,983)	($3,125)	($3,115)	($2,860)	($13,083)	($3,413)	($3,627)	($3,454)	($3,647)	($14,141)
Equity income from unconsolidated JVs	$64,433	$49,570	$13,601	$12,001	$8,314	$0	$33,916	($908)	($1,409)	$160	$15,388	$13,231	$0	$0	$0	$0	$0
Oper. Income from discontinued opers.	$74,444	$33,034			$52		$0			$1,445	$26,847	$0					$0
Income taxes	($5,829)	($250)	$77	$4,563	$1,980	$2,391	$9,011	($53,038)	$2,003	$0	($3,372)	($54,407)	$0	$0	$0	$0	$0
Gain on extinguishment of debt	$0	$0					$0					$0					$0
Other income	$16,436	($28,385)							$2,280		($47,430)						
Participating securities share	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
(Loss)/Gain on sale of assets	$0	$0	$0	$0	$0	$0	$0	$1,222	$119,614	$0	$0	$120,836	$0	$0	$0	$0	$0
Income Bef. Preferred div	$969,037	$919,796	($240,949)	$164,515	$115,046	($594,617)	($556,057)	$115,762	$301,375	$150,924	$58,440	$643,359	$84,093	$89,372	$85,114	$89,868	$348,447
Preferred dividends	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Net Income for common	$969,037	$919,796	($240,949)	$164,515	$115,046	($594,617)	($556,057)	$115,762	$301,375	$150,924	$58,440	$643,359	$84,093	$89,372	$85,114	$89,868	$348,447
Per share bef. Extra	$2.13	$2.00	($0.52)	$0.36	$0.25	($1.26)	($1.20)	$0.25	$0.64	$0.32	$0.12	$1.37	$0.18	$0.19	$0.18	$0.19	$0.74
Extraordinary item	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Net (loss) income per share	$2.13	$2.00	($0.52)	$0.36	$0.25	($1.26)	($1.20)	$0.25	$0.64	$0.32	$0.12	$1.37	$0.18	$0.19	$0.18	$0.19	$0.74
Quarterly dividend rate	$2.10	$2.18	$0.57	$0.57	$0.57	$0.57	$2.26	$0.58	$0.58	$0.37	$0.37	$1.89	$0.37	$0.37	$0.37	$0.38	$1.49
Shs Outstanding (diluted)	455,511,600	458,788,750	460,880,000	462,106,000	463,586,000	471,273,000	464,461,250	466,262,000	471,425,000	467,835,000	468,210,000	468,433,000	472,560,000	473,010,000	473,460,000	473,910,000	473,235,000

* - Does not add up due to inter-year changes

Table 5. Funds From Operations Calculation

	2013 Year	2014 Year	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2015 Year	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2016 Year	2017E Q1	2017E Q2	2017E Q3	2017E Q4	2017E Year
Net income for common shareholders	$969,037	$919,796	($240,949)	$164,515	$115,046	($599,164)	($556,057)	$115,762	$301,375	$150,924	$58,440	$643,359	$84,093	$89,372	$85,114	$89,868	$348,447
Add Back:																	
Depreciation	426,402	459,995	121,206	125,531	139,908	141,156	527,801	144,284	144,360	145,374	147,416	572,509	141,702	142,416	144,320	146,819	565,257
JV Adjustment	3,310	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other	(14,929)	26,084	$487,219	$78,474	$114,289	$832,942	1,512,924	2,475	25,258	17,568	72,659	117,960	5,000	5,000	5,000	5,000	20,000
Non-recurring/misc.	-	-	$0	$0	$0	$0	-	$0	$0	$0	$0	-	$0	$0	$0	$0	-
Deduct:																	
Gain/loss on sales of real estate	$0	$0	$0	$0	$0	$0	$0	$62,842	($119,614)	$0	$0	($120,836)	$0	$0	$0	$0	$0
FFO Available for common	$1,383,820	$1,410,644	$367,476	$368,520	$369,243	$374,934	$1,484,668	$325,363	$351,379	$313,866	$278,515	$1,212,992	$230,795	$236,788	$234,434	$241,687	$933,704
Diluted FFO available for common	$1,388,863	$1,410,644	$367,476	$368,520	$369,243	$374,934	$1,480,173	$325,363	$351,379	$313,866	$278,515	$1,269,123	$230,795	$236,788	$234,434	$241,687	$943,704
Basic FFO per share	$3.02	$3.04	$0.79	$0.79	$0.79	$0.80	$3.17	$0.70	$0.75	$0.67	$0.60	$2.72	$0.49	$0.50	$0.50	$0.51	$2.00
Diluted FFO per share	$3.01	$3.04	$0.79	$0.79	$0.79	$0.80	$3.16	$0.69	$0.74	$0.67	$0.59	$2.71	$0.49	$0.50	$0.50	$0.51	$1.99
Shares, basic	460,350,500	463,470,750	465,610,000	466,836,000	468,240,000	469,923,000	467,652,250	464,912,000	470,075,000	466,485,000	466,860,000	467,083,000	471,210,000	471,660,000	472,110,000	472,560,000	471,885,000
Shares, diluted	461,700,500	464,820,750	466,960,000	468,186,000	469,590,000	471,273,000	469,002,250	466,262,000	471,425,000	467,835,000	468,210,000	468,433,000	472,560,000	473,010,000	473,460,000	473,910,000	473,235,000

Table 6. Funds Available for Distribution Calculation

	2013 Year	2014 Year	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2015 Year	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2016 Year	2017E Q1	2017E Q2	2017E Q3	2017E Q4	2017E Year
FFO Available for common	$1,383,820	$1,410,644	$367,476	$368,520	$369,243	$374,934	$1,484,668	$325,363	$351,379	$313,866	$278,515	$1,212,992	$230,795	$236,788	$234,434	$241,687	$933,704
Less:																	
Recurring real estate CAPX	($52,988)	($53,974)	($13,726)	($15,351)	($15,481)	($15,627)	($60,185)	($15,394)	($15,402)	($15,414)	($14,616)	($60,825)	($14,628)	($14,766)	($15,028)	($15,291)	($59,713)
Straight-line adjustment (ACR)	($56,000)	($56,000)	($14,000)	($14,000)	($14,000)	($14,000)	($56,000)	($14,000)	($14,000)	($14,000)	($14,000)	($56,000)	($14,000)	($14,000)	($14,000)	($14,000)	($56,000)
Non-real estate depreciation, other	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Funds available for distribution	$1,274,832	$1,300,670	$339,750	$339,169	$339,762	$345,307	$1,368,483	$295,969	$321,977	$284,452	$249,899	$1,096,167	$202,167	$208,022	$205,405	$212,396	$817,991
Per share	$2.77	$2.81	$0.73	$0.73	$0.73	$0.73	$2.93	$0.64	$0.68	$0.61	$0.54	$2.35	$0.43	$0.44	$0.44	$0.45	$1.73

Source: Company reports and Hilliard Lyons estimates

Additional information is available upon request.

Analyst Certification

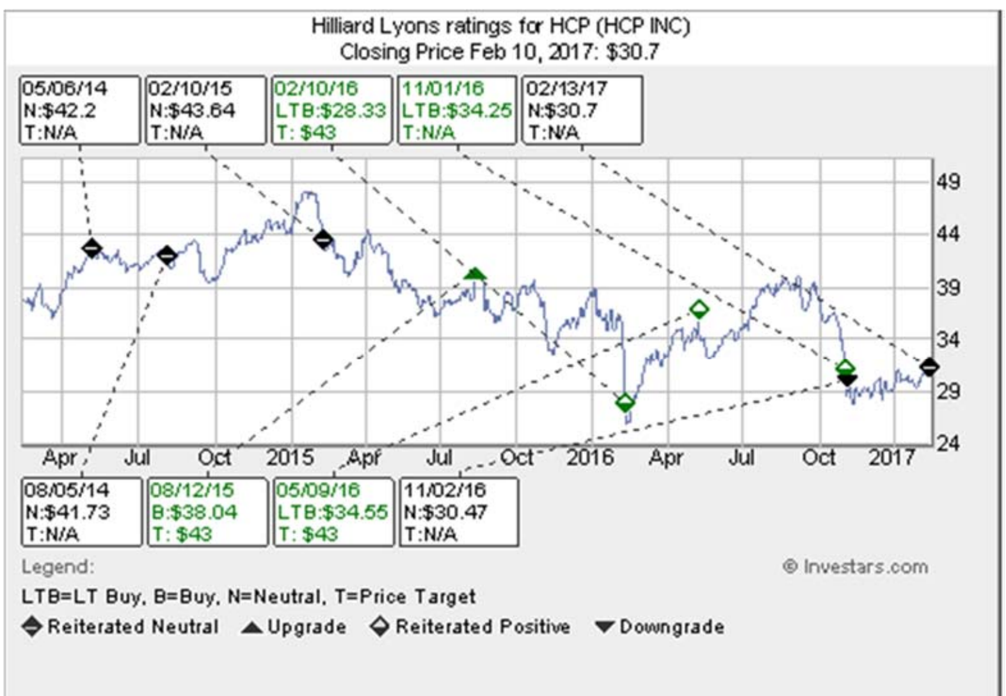
I, John M. Roberts, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings
1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base.



	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017

Other Disclosures

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

J.J.B. Hilliard, W.L. Lyons, LLC is a multi-disciplined financial services firm that regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as placement agent in private transactions.

The information herein has been obtained from sources we believe to be reliable but is not guaranteed and does not purport to be a complete statement of all material factors. This is for informational purposes and is not a solicitation of orders to purchase or sell securities.